

"Real Estate Investing Made Simple, Profitable ... and Fun!"

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Bonus Case Studies

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Bonus Case Study #1

You are considering the purchase of the following 20,000 square foot strip mall located in an outlying suburb near your town. Please use the Investment Property Worksheet to calculate your financial benefits and rate of return.

Purchase cost:	\$3,300,000
Cash invested:	\$1,000,000
Financing:	\$2,300,000 @ 5.75% @ \$16,150.00 per month P&I
Net Rent:	\$16.00 per square foot
Vacancy rate:	12%
Tax bracket:	35% (combined State and Federal)
Land value:	\$900,000
*Personal property value:	\$50,000 (The personal property depreciation in a non-residential purchase is treated as 7-year, or 5-year depending on several issues. Assume the personal property included in this case study qualifies for 5-year depreciation.)
Building value:	\$1,550,000
Land improvements:	\$800,000
First year interest:	Please use your financial calculator to determine
Purchase date:	January
Operating expenses:	Tenant pays all except for management fee which equals 4% of Gross Operating Income

Bonus Case Study # 2

You have been asked to evaluate the following 16-unit apartment building and research shows that lenders require thirty percent down with a 7.5% interest rate amortized over twenty years. You have also learned that investors in the region demand 12% cash on cash for apartment buildings of this type. Please determine this property's investment value.

Income: 6 units at \$600 per month
 6 units at \$750 per month
 4 units at \$1,000 per month
 16 garages at \$45 per month each
 Washer/dryer income of \$100 per month

Vacancy: 10%

Operating expenses:

Utilities: \$11,000
Real estate tax: \$19,000
Insurance: \$2,400
Repairs: \$7,400
Advertising: \$1,350
Supplies: \$2,200
Management: 5% of gross operating income

Annual rent	_____
minus: vacancy	_____
equals: gross operating income	_____
minus: operating expenses	_____
equals: net operating income	_____

Bonus Case Study #3

Your best client, Rudy, is a former professional football player who parlayed his success on the football field into a real estate investing career. He was not a Hall of Fame player but Rudy really knows what he's doing when it comes to real estate!

Rudy's success in real estate comes from the fact that he defines his investment goals and sticks to them. If the property doesn't meet his requirements he won't buy it. He'll only buy if he can receive a ten percent "cash-on-cash" return with twenty-five percent down payment.

As a matter of fact, he called you yesterday and asked you to check on an apartment building located in a terrific area in your town. Rudy says he'd be interested in buying the property if he can reach his cash on cash return of ten percent.

You promise to do some research and get back to him within two days. And, true to your word, your research indicates the following:

Property type:	Apartment building
Gross scheduled income:	\$175,000
Vacancy:	About 8%
Operating expense ratio:	42%
Available financing:	25% down payment 9% interest Amortized over 15 years
Personal property value:	5% of purchase price
Land improvements:	10% of purchase price
Building/land ratio:	80% / 20%
Date purchased:	January

Please determine the following:

- A. The purchase price which will meet Rudy's goals (rounded to the nearest \$1000).
- B. The cash flow before tax, principal reduction and income tax savings (assume Rudy is able to use the tax shelter created by this property).

Bonus Case Study #4

Your dentist has told you he owns a great little office building across the street from his dental practice. He says he bought it about 12 years ago and it's been a wonderful investment - more than doubling in value.

You ask him if he knows his return on equity and he doesn't know what you're talking about. You agree to meet at your office in a couple days to explain but in the meantime you learn the following:

Current value:	\$1,000,000
Current loans:	280,000 @ 7% @ 1,900/month
Current rent:	9,000 per month
Vacancy:	9%
Operating expenses:	37,800
Total depreciation for this year:	10,100
This year's interest	19,495
Transaction costs (if he were to sell)	8%
Tax bracket:	35%

- Please calculate his "net equity." (It's the amount he'd walk away from the closing with, if he sold.)
- Use the Investment Property Worksheet to calculate his return on equity.
- What suggestions would you make to him?

Bonus Case Study #5

Last year you bought a furnished condo in Scottsdale, Arizona for \$220,000 to use as a rental unit. Your accountant advised you that your share of the land (common area) is probably about \$20,000 so the building would be \$200,000.

How much depreciation and tax savings (35% state and federal tax bracket) would you receive in the first two years?

But you are a lean, mean bifurcating machine and you know that you should separate the \$220,000 purchase cost into four items. Assume the personal property is \$30,000 and your share of the land improvements total \$18,000.

NOW, how much depreciation and tax savings (35% state and federal tax bracket) would you receive in the first two years?

**Answers on the
following pages**

Investment Property Worksheet

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Purchase cost \$ 3,300,000
 Cash invested \$ 1,000,000
 Financing: Amount 2,300,000 Rate 5.75% P&I 16,150 per month $\times 12 = 193,800$
 Financing: Amount _____ Rate _____ P&I _____ per month

Land value \$ 900,000
 Personal property value \$ 50,000 $\times 20\% =$ \$ 10,000
 Building value \$ 1,550,000 $\times 2.46\% =$ \$ 38,130
 Land improvement value \$ 800,000 $\times 5\% =$ \$ 40,000
 Total depreciation \$ 88,130

Annual rent 320,000 Less vacancy 38,400 = Gross operating income 281,600

Annual operating expenses

Real estate tax _____	Insurance _____
Repairs _____	Utilities _____
Association dues _____	Advertising _____
Management <u>11,264</u>	Supplies _____
Miscellaneous _____	Miscellaneous _____

Total operating expenses \$ 11,264

I. Gross operating income	<u>\$ 281,600</u>	
Minus: operating expenses	<u>\$ 11,264</u>	
Equals: net operating income	<u>= \$ 270,336</u>	
Minus: annual debt service (monthly P&I x 12)	<u>\$ 193,800</u>	
Equals: cash flow before tax	<u>= \$ 76,536</u>	
II. Annual debt service	<u>\$ 193,800</u>	
Minus: interest	<u>\$ 130,602</u>	
Equals: principal reduction	<u>= \$ 63,198</u>	
III. Net operating income	<u>\$ 270,336</u>	
Minus: interest	<u>\$ 130,602</u>	
Minus: total depreciation	<u>\$ 88,130</u>	
Equals: taxable income	<u>= \$ 51,604</u>	
Multiplied by tax bracket	<u>x 35%</u>	
Equals: tax paid or saved	<u>= \$ 18,061 paid</u>	
IV. Appreciation (estimate)	<u>\$ 0</u>	

Return on investment with appreciation
Cash flow before tax + Principal reduction + Tax saved + Appreciation = _____ %
 Cash invested _____

Return on investment without appreciation $76,536 + 63,198 + (18,061) = \frac{121,673}{1,000,000} = 12.2\%$
Cash flow before tax + Principal reduction + Tax saved = _____ %
 Cash invested _____

Capitalization rate
Net operating income = _____ %
 Purchase cost _____

Cash on cash
Cash flow before tax = _____ %
 Cash invested _____

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16 UNIT APARTMENT

ANNUAL RENT	155,040
- VACANCY (10%)	- 15,504
= GROSS OPERATING INCOME	<u>139,536</u>
- OPERATING EXPENSES	- 50,327
= NOI	<u>89,209</u>

* The management fee is
5% of 139,536

"Float and Desire" Formula

The five ingredients are:

Loan factor	=	<u>.0966712</u>
LTV	=	<u>.70</u>
Down payment	=	<u>.30</u>
Cash on cash	=	<u>.12</u>
NOI	=	<u>89,209</u>

Four step "recipe":

1. Lender's return	=	<u>.70</u>	x	<u>.0966712</u>	=	<u>.0676698</u>
		(LTV)		(Loan factor)		
2. Buyer's return	=	<u>.30</u>	x	<u>.12</u>	=	<u>.036</u>
		(Down payment)		(Cash on cash)		
3. Add 'em up	=	<u>.0676698</u>	+	<u>.036</u>	=	<u>.1036698</u>
		(Lender's return)		(Buyer's return)		Cap rate
4. Value	=	<u>89,209</u>	÷	<u>.1036698</u>	=	<u>860,511</u>
		(NOI)		(Cap rate)		Investment value

Double check:

		<u>860,511</u>	Investment value
minus		<u>258,153</u>	Down payment
equals		<u>602,358</u>	Loan amount
		<u>258,153</u>	Down payment
times		<u>.12</u>	Cash on cash
equals		<u>30,978</u>	Cash flow before tax
		<u>89,209</u>	NOI
minus		<u>30,978</u>	Cash flow before tax
equals		<u>58,231</u>	Debt service
divided by		<u>.0966712</u>	Loan factor
equals		<u>602,361</u>	Loan amount (loan amounts should be equal)

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"Float and Desire" Formula

The five ingredients are:

Loan factor	=	<u>.1217120</u>
LTV	=	<u>.75</u>
Down payment	=	<u>.25</u>
Cash on cash	=	<u>.10</u>
NOI	=	<u>93,380</u>

Four step "recipe":

1. Lender's return	=	<u>.75</u>	x	<u>.1217120</u>	=	<u>.0912840</u>
		(LTV)		(Loan factor)		
2. Buyer's return	=	<u>.25</u>	x	<u>.10</u>	=	<u>.025</u>
		(Down payment)		(Cash on cash)		
3. Add 'em up	=	<u>.0912840</u>	+	<u>.025</u>	=	<u>.1162840</u>
		(Lender's return)		(Buyer's return)		Cap rate
4. Value	=	<u>93,380</u>	÷	<u>.1162840</u>	=	<u>803,034</u>
		(NOI)		(Cap rate)		Investment value

Double check:

		<u>803,034</u>	Investment value
minus		<u>200,759</u>	Down payment
equals		<u>602,275</u>	Loan amount
		<u>200,759</u>	Down payment
times		<u>.10</u>	Cash on cash
equals		<u>20,076</u>	Cash flow before tax
		<u>93,380</u>	NOI
minus		<u>20,076</u>	Cash flow before tax
equals		<u>73,304</u>	Debt service
divided by		<u>.1217120</u>	Loan factor
equals		<u>602,274</u>	Loan amount (loan amounts should be equal)

175,000
- 14,000 val
<u>161,000 NOI</u>
- 67,620 opex
<u>93,380 NOI</u>

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"Rudy"

Investment Property Worksheet

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Purchase cost \$ 803000 Rudy
 Cash invested \$ 200750
 Financing: Amount 602250 Rate 9 P&I 6108 per month $\times 12 = 73296$
 Financing: Amount _____ Rate _____ P&I _____ per month

Land value \$ 136510 Depreciation
 Personal property value \$ 40150 $\times 20\% =$ \$ 8030
 Building value \$ 546040 $\times 3.48\% =$ \$ 19002
 Land improvement value \$ 80300 $\times 5\% =$ \$ 4015
 Total depreciation \$ 31047
 Annual rent 175000 Less vacancy 14000 = Gross operating income 161000

Annual operating expenses
 Real estate tax _____ Insurance _____
 Repairs _____ Utilities _____
 Association dues _____ Advertising _____
 Management _____ Supplies _____
 Miscellaneous _____ Miscellaneous _____
 Total operating expenses \$ 67620 (4290)

I. Gross operating income \$ 161000
 Minus: operating expenses \$ 67620
 Equals: net operating income = \$ 93380
 Minus: annual debt service (monthly P&I x 12) \$ 73296
 Equals: cash flow before tax = \$ 20084
 II. Annual debt service \$ 73296
 Minus: interest \$ 53395
 Equals: principal reduction = \$ 19901
 III. Net operating income \$ 93380
 Minus: interest \$ 53395
 Minus: total depreciation \$ 31047
 Equals: taxable income = \$ 8938
 Multiplied by tax bracket x 35%
 Equals: tax paid or saved = \$ 3128 paid

Return on investment with appreciation
 Cash flow before tax + Principal reduction + Tax saved + Appreciation = _____ %
 Cash invested

Return on investment without appreciation $20084 + 19901 + (3128) = 36857 = 18.4\%$
 Cash flow before tax + Principal reduction + Tax saved 200750 %
 Cash invested

Capitalization rate
 Net operating income 93380 = 11.6%
 Purchase cost 803,000

Cash on cash
 Cash flow before tax 20084 = 10%
 Cash invested 200,750

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Purchase cost		\$			
Cash invested NET EQUITY		\$	<u>640,000</u>		
Financing:	Amount <u>280,000</u>	Rate <u>7</u>	P&I <u>1900</u>	per month	
Financing:	Amount _____	Rate _____	P&I _____	per month	
Land value	\$ _____			Depreciation	
Personal property value	\$ _____	x _____	% = \$ _____		
Building value	\$ _____	x _____	% = \$ _____		
Land improvement value	\$ _____	x _____	% = \$ _____		
Total depreciation				\$ <u>10,100</u>	
Annual rent	<u>108,000</u>	Less vacancy <u>9720</u>	= Gross operating income	<u>98,280</u>	
Annual operating expenses					
Real estate tax	_____		Insurance	_____	
Repairs	_____		Utilities	_____	
Association dues	_____		Advertising	_____	
Management	_____		Supplies	_____	
Miscellaneous	_____		Miscellaneous	_____	
Total operating expenses	\$ <u>37,800</u>				
I. Gross operating income		\$	<u>98,280</u>		
Minus: operating expenses		\$	<u>-37,800</u>		
Equals: net operating income		\$	<u>60,480</u>		
Minus: annual debt service (monthly P&I x 12)		\$	<u>-22,800</u>		
Equals: cash flow before tax		\$	<u>37,680</u>		
II. Annual debt service		\$	<u>22,800</u>		
Minus: interest		\$	<u>19,495</u>		
Equals: principal reduction		\$	<u>3,305</u>		
III. Net operating income		\$	<u>60,480</u>		
Minus: interest		\$	<u>-19,495</u>		
Minus: total depreciation		\$	<u>-10,100</u>		
Equals: taxable income		\$	<u>30,885</u>		
Multiplied by tax bracket		x	<u>35%</u>		
Equals: tax paid or saved		\$	<u>10,810 paid</u>		
IV. Appreciation (estimate)		\$	_____		
Return on investment with appreciation					
Cash flow before tax + Principal reduction + Tax saved + Appreciation	=	_____	%		
Cash invested					
Return on investment without appreciation					
Cash flow before tax + Principal reduction + Tax saved	=	<u>37,680 + 3,305 + (10,810)</u>	<u>= 30,175</u>		
Cash invested			<u>640,000</u>		
Capitalization rate					
Net operating income	=	_____	%		
Purchase cost					
Cash on cash					
Cash flow before tax	=	_____	%		
Cash invested					

4.7%

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\$220,000 rental condo

<u>No bifurcating</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Total</u>
20,000 land	0	0	0
200,000 building	6,960	7,280	14,240
			<u>35%</u>
			4,984 saved

<u>With bifurcating</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Total</u>
30,000 personal prop.	6000	9,600	15,600
18,000 land improve	900	1,710	2,610
20,000 land	0	0	0
152,000 building	5,290	5,533	<u>10,823</u>
			29,033
			<u>35%</u>
			10,162 saved

\$5,178 difference